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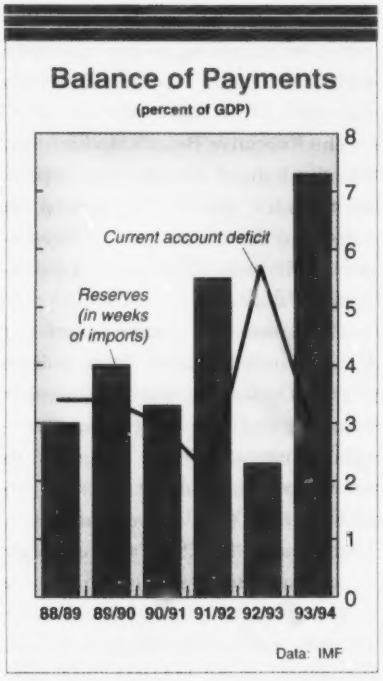
Pakistan Steps Up Macroeconomic Adjustment and Structural Reform

On February 22, the IMF approved arrangements totaling SDR 986 million (about $1.3 billion) under the enhanced structural adjustment facility (ESAF) and the extended Fund facility (EFF) in support of Pakistan's medium-term adjustment and reform program. In the following article, Antonio Furtado and Shamsuddin Tareq, of the IMF's Middle Eastern Department, review key elements of Pakistan's adjustment process.

During the 1980s, Pakistan's economy achieved high rates of economic growth and a steady rise in per capita income. However, a number of structural weaknesses undermined the sustainability of its growth and heightened its vulnerability to external shocks. These weaknesses included a narrow and fragmented tax base, distortionary administrative pricing of key commodities, excessive involvement of the public sector in domestic production and trading, regulatory constraints on private investment, and a restrictive trade and payments regime. In addition, Pakistan's financial system was dominated by government-owned institutions and characterized by quantitative credit allocations, distorted rates of return, and a proliferation of public debt instruments with administratively determined yields.



To address these weaknesses and to place its economy *(Please turn to page 74)*

New ESAF Begins Operations

The IMF's renewed and enlarged concessional lending window—the enhanced structural adjustment facility (ESAF)—has begun operations. The renewed facility, which will have the same terms and conditions as the original ESAF, seeks to ensure the continuity of concessional lending by the IMF to low-income countries undertaking economic and structural reforms. Eligibility for the ESAF has also been extended to six additional member countries, bringing the total number of eligible countries to 78. (See box on page 66.)

The ESAF successor will emphasize an integrated approach to reform programs. It will focus on:

- integrating social safety nets into ESAF programs;
- integrating contingency mechanisms to protect programs against adverse external shocks; and
- providing well-targeted technical assistance and coordinating this assistance with that from the World Bank and other institutions.

Citing the successes of the first ESAF in helping low-income members improve their economic performance, IMF Managing Director Michel Camdessus said, "Now we will be able to continue to provide that assistance. This decision reinforces the global role that the IMF is playing." (See page 66.)

Enlarged ESAF Financed by Industrial and Developing Countries

The Executive Board of the IMF decided today to initiate operations under the enlarged and extended enhanced structural adjustment facility (ESAF) Trust in accordance with the decision of the Executive Board on December 15, 1993. At the same time, the Executive Board added Armenia, Cameroon, Georgia, the Kyrgyz Republic, Tajikistan, and the former Yugoslav Republic of Macedonia to the list of IMF members eligible to receive loans under the ESAF (see box).

The Executive Board's decision was taken in light of the successful experience under the ESAF, created in 1987, and the strong need of low-income IMF member countries for concessional financing.

The terms and conditions of the ESAF remain the same. Loans will be provided to low-income IMF member countries that are undertaking three-year economic reform programs to strengthen their balance of payments and improve their growth prospects. Loans under the ESAF will continue to carry an interest rate of 0.5 percent a year and will be repayable over 10 years with a 5½ year grace period. It is expected that programs under the ESAF will henceforth pay greater attention to social safety nets; include, where feasible, contingency mechanisms to protect programs against unforeseen external shocks; and better integrate technical assistance into program design. The programs will also seek to strengthen the quality of public spending.

The enlarged ESAF will be financed by contributions from a broad cross-section of the IMF's membership. To date, commitments and indications to contribute have been received from 43 members. Including the IMF's SDR 600 million, contributions to the Subsidy Account of the enlarged ESAF total SDR 2 billion, or 95 percent of the target of SDR 2.1 billion (about US$3 billion). To date, 40 member countries have indicated their contributions to the Subsidy Account, and others are in the process of taking decisions. Twenty-four developing countries are providing more than 20 percent of the contributions to the ESAF's Subsidy Account, compared with the 6 developing countries that provided 8 percent of the contributions to the original ESAF. Contributions to the Capital Account have been received from 11 countries—3 of which are developing countries—totaling SDR 4.5 billion (about US$6.3 billion), or 90 percent of the SDR 5 billion target (about US$7 billion), and additional loan contributions are being sought.

IMF Managing Director Michel Camdessus said he was particularly pleased that the enlarged ESAF was now operational and that there was such widespread participation by IMF members in providing contributions. "The first ESAF has been a valuable tool in assisting those low-income members undertaking strong programs to improve their economic performance. Now we will be able to continue to provide that assistance. This decision reinforces the global role that the IMF is playing, and I am especially pleased with the solidarity shown by so many developing countries in helping to finance the enlarged ESAF.

"Countries that are willing to adopt courageous programs of adjustment can do so in the knowledge that the IMF will continue to support them and act as a catalyst for financing from other official and private sources. The new ESAF will be a particularly useful instrument in assisting low-income countries undertaking major reforms, including many of the countries in the CFA franc zone that are restructuring their economies in the wake of the devaluation earlier this year," Camdessus said. Press Release No. 94/8, February 23

Low-Income Countries Eligible for ESAF

The following member countries of the IMF are eligible for assistance under the enhanced structural adjustment facility: Afghanistan, Albania, Angola, Armenia, Bangladesh, Benin, Bhutan, Bolivia, Burkina Faso, Burundi, Cambodia, Cameroon, Cape Verde, Central African Republic, Chad, People's Republic of China, Comoros, Côte d'Ivoire, Djibouti, Dominica, Dominican Republic, Egypt, Equatorial Guinea, Ethiopia, The Gambia, Georgia, Ghana, Grenada, Guinea, Guinea-Bissau, Guyana, Haiti, Honduras, India, Kenya, Kiribati, Kyrgyz Republic, Lao P.D.R., Lesotho, Liberia, former Yugoslav Republic of Macedonia, Madagascar, Malawi, Maldives, Mali, Mauritania, Mongolia, Mozambique, Myanmar, Nepal, Nicaragua, Niger, Nigeria, Pakistan, Philippines, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, Sri Lanka, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Sudan, Tajikistan, Tanzania, Togo, Tonga, Uganda, Vanuatu, Viet Nam, Western Samoa, Republic of Yemen, Zaïre, Zambia, and Zimbabwe.

Reform of U.S. Health Care System Seeks Universal Coverage, Lower Costs

Almost alone among the major industrial countries, the United States has no nationwide system of uniform health insurance. Although dispensing what is generally acknowledged to be high-quality care, the U.S. system—a complex mix of public and private insurance—has been criticized for its high costs and inadequate coverage.

In "U.S. Health Care Reform," an IMF Working Paper, Ellen M. Nedde looks at the inefficiencies and inequities of the present U.S. health care system and discusses how a system of universal coverage under managed competition could deal with these problems.

Who Is Covered and How

About three-fourths of the U.S. population is covered by private health insurance (of which about 80 percent is through an employer), provided by over one thousand private health insurance companies. The coverage provided by these companies has traditionally been based on the indemnity insurance model, under which inpatient care receives generous coverage, but preventive services get short shrift. Recent years have seen the proliferation of health maintenance organizations, which combine the financing and delivery of medical care and emphasize preventive care.

Public insurance is available to the elderly under Medicare and to certain narrowly designated groups of the poor under Medicaid. Both schemes have weaknesses: Medicare covers less than one half of the total medical costs of the elderly; Medicaid typically reaches less than half the population with incomes below the poverty level.

Who Is Not Covered and Why

An estimated 35 million people (14 percent of the population) have no health insurance at all. The uninsured fall roughly into three groups:

- Poor or near-poor. In 1990, one-third of the uninsured were members of families with incomes below the poverty line ($13,254 for a family of four), and two-thirds were in families whose incomes were less than twice the poverty line.
- Employed but not insured by their employer. In 1990, close to 90 percent of the uninsured were workers (or their dependents). Most worked in small firms, which face barriers to insurance in the form of high administrative costs per worker and the underwriting practices of the health insurance industry.
- Under age 25. In 1990, 43 percent of the uninsured were under age 25 (26 percent were under 18). Many uninsured youths were very young (in 1990, 12 percent were under age 5). Although the young uninsured may receive some medical care, it is likely to be expensive emergency room care, rather than preventive care.

U.S. Spends More on Health Care Than Other OECD Countries

"The United States," writes Nedde, "spends a larger share of its GDP on health care than any other OECD [Organization for Economic Cooperation and Development] country." (See chart on page 68.) This spending has been rising rapidly over the past several years, growing at an annual compound rate of 10¼ percent during the period 1980-90.

In 1990, OECD countries spent an average of 7½ percent of GDP on health care; in the United States that figure was 12 percent, rising to 13 percent in 1991, and to an estimated 14 percent in 1992.

Another telling comparison between the United States and other OECD countries is the amount of health care spending financed by the public sector: in 1990, the OECD average was 75 percent compared with 42 percent in the United States, of which federal financing represented about two thirds. Although this share has remained fairly stable since the mid-1970s, rising outlays for health care are expected to put heavy pressure on federal and state budgets in the coming years. By the year 2000, according to U.S. Congressional Budget Office projections, outlays on health care will absorb over 28 percent of federal revenues, compared with about 18 percent in 1992. "In fact," writes Nedde, "escalating health-related outlays are the principal source of the deteriorating medium-term fiscal outlook foreseen by the Congressional Budget Office and the Administration."

The Economics of Health Care

The U.S. health care market is plagued by inefficiencies, according to Nedde. These inefficiencies translate into the overconsumption of health services by the insured segment of society. Two characteristics of the U.S. health care market encourage overconsumption:

- Third-party payer. The direct costs of medical treatment are borne not by the health care consumer, but by a distant payer that plays no part in the treatment decision. This practice tends to encourage high levels of spending.

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• Supplier-induced demand. Consumers cannot assess the value of the treatment they receive because they lack adequate information about the price and quality of medical services, and they therefore delegate responsibility for making these judgments to health care providers. The providers are thus put in the position of acting as agents for consumers as well as suppliers of medical care. "Providers," writes Nedde, "are both ethically bound and financially motivated to encourage their patients to receive treatments no matter how small the benefit and regardless of cost."

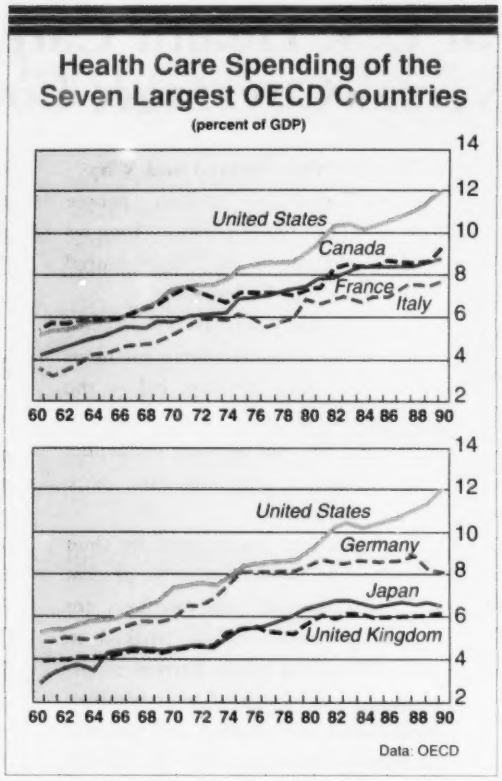
High Health Care Costs Continue to Climb

The inefficiencies of the health care market have contributed to the high and rising cost of health services in the United States. Specifically, the high spending levels are attributable to:

• High administrative costs. Administrative expenses, including insurance overhead, physicians' overhead and billing, and hospital and nursing administration, consumed an estimated 19–24 percent of health care spending in 1987 (compared with 8–11 percent in Canada).

• Excess capacity. An estimated 5–20 percent of total health care outlays goes to unnecessary spending on high-technology facilities and equipment, and medically inappropriate health services. A 1989 review conducted by the U.S. General Accounting Office found that 14-32 percent of surgical procedures and 7-19 percent of hospital admissions were unnecessary.

The chief reasons for the rapid rise in spending on health care in the United States—from 1960 to 1990, real per capita spending rose by a factor of four include:



• rising incomes;

• new medical technologies and procedures;

• rising administrative expenses; and

• medical price inflation in excess of general inflation.

The available evidence suggests that the current U.S. system offers incentives for the development of new and expensive medical technologies. The third-party payer system, mentioned above, actually encourages the adoption of these technologies, no matter how high the cost or small the benefit. "If," says Nedde, "the current retrospective cost-based payment system encourages cost-increasing technological changes, then a move to a prospective fixed-fee system should encourage more cost-saving innovations."

Photo Credits: Denio Zara and Padraic Hughes for IMF.

How Reforms Would Affect Current System

The U.S. Administration's proposals for reform of the health care system have two objectives: to provide universal coverage and to control costs. How various alternative proposals would affect the current health care system ranges from minor to fundamental:

• *Tax credits* would make the current system more affordable to lower-income groups but would otherwise have no effect on the voluntary, employer-provided health insurance system. This scheme includes no incentives for cost control.

• *"Play or pay,"* which also has no incentives for cost control, requires employers either to provide health insurance to their employees or to pay a payroll tax to cover their employees' enrollment in a public health care plan.

• *Managed competition,* which underlies the Administration's proposals, would entail a more fundamental change. It provides for universal coverage and would concentrate on cost control.

• *National health insurance* represents an even larger departure from the current system. Under it, the Government would replace all private insurance companies as a single insurer, giving it considerable scope to control costs and reduce administrative expenses.

Managed Competition: The Answer?

Under managed competition, government regulations would help ensure an equitable distribution of resources and address the special characteristics of the health care market.

Elements of competition are introduced to encourage cost-consciousness among consumers, providers, and insurers. Health cooperatives—regional

agencies—would negotiate contracts with health plans, bargain over the prices of benefits, and oversee quality.

Managed competition would have an effect on all the players in the health care system:

• *Consumers* under the present system have little incentive and insufficient information about quality and extent of coverage to permit them to discriminate among health plans based on price. Under managed competition, all plans would have to offer a standardized health benefit package, and consumers would have ready access to indicators of the quality of care under each plan.

• *Insurers* would be required to offer the standard benefit package to everyone, regardless of pre-existing conditions. They would thus be encouraged to compete by offering low-cost plans, rather than by trying to attract only the relatively healthy.

• *Providers*, in order to be affiliated with a health plan, would compete on the basis of their cost effectiveness, maintaining quality rather than offering the latest costly high-technology procedures (regardless of their benefit) and unnecessary amenities.

Managed competition, writes Nedde, would thus provide indirect incentives for reduced consumption: "consumers economize on their purchase of health insurance, causing insurers to compete for enrollees and to put pressure on the providers with which they are affiliated to practice medicine conservatively."

The Bottom Line

Some proponents of managed competition have argued for global budgets or government-regulated limits on national health expenditures. "Whether health care reform based on managed competition will need to rely on global budgets to control spending over the longer term," Nedde concludes, "depends in large part on the extent to which it can encourage cost-saving rather than cost-increasing technologies." ■

Copies of "U.S. Health Care Reform," WP/93/93 in the IMF's Working Paper series, are available for $7.00 from Publication Services, Box XS400, International Monetary Fund, Washington, D.C. 20431, U.S.A. (Telephone: (202) 623-7430; fax: (202) 623-7201.)

From the Executive Board . . .

Grenada: Acceptance of Article VIII. The Government of Grenada has notified the International Monetary Fund that it has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the IMF Articles of Agreement with effect from January 24, 1994. IMF members accepting the obligations of Article VIII undertake to refrain from imposing restrictions on the making of payments and transfers for current international transactions or from engaging in discriminatory currency arrangements or multiple currency practices without IMF approval. Grenada is the eighty-fourth member of the IMF to assume Article VIII status.

Two of the main purposes of the IMF, as stated in its Articles of Agreement, are to facilitate the expansion and balanced growth of international trade, and thereby to contribute to the promotion and maintenance of high levels of employment and real income; and to assist in the establishment of a multilateral system of payments in respect of current transactions between IMF members. In seeking to achieve these objectives, the IMF exercises firm surveillance over the exchange rate policies of its members and oversees the elimination of exchange restrictions that hamper the growth of world trade.

By accepting the obligations of Article VIII, Grenada gives confidence to the international community that it will pursue sound economic policies that will obviate the need to use restrictions on the making of payments and transfers for current international transactions, and thereby contributes to a multilateral payments system free of restrictions.

Grenada has been a member of the IMF since August 27, 1975, and its quota in the IMF is SDR 8.5 million (about US$11.7 million). Press Release No. 94/6, February 15

Pakistan: ESAF and EFF. The International Monetary Fund has approved the use of its financial resources totaling SDR 985.7 million (about US$1.369 billion) over the next three years by Pakistan in support of the Government's medium-term economic adjustment and reform program. Of the total, SDR 606.6 million (about US$842 million) will be financed from loans under the enhanced structural adjustment facility (ESAF), and SDR 379.1 million (about US$526 million) from the extended Fund facility (EFF). The first annual ESAF loan is for SDR 202.2 million (about US$281 million) and will be disbursed in two equal semi-annual installments.

Pakistan initiated a comprehensive economic reform program in 1988, under which important gains have been achieved. The program included measures to liberalize domestic activity and the external trade and payments system, reform the financial sector, and implement a wide-ranging privatization program. This has contributed to stronger economic and export growth, greater output diversification, higher domestic and foreign investment, and increased vitality of the private sector. The country, however, has remained vulnerable to external developments, and in 1992/93 it was affected by widespread floods and unfavorable terms of trade, which compounded the impact of weak financial policies and political uncertainties.

In light of these developments, the Government of Pakistan has developed a medium-term strategy, supported by the ESAF and EFF financing, that seeks an early strengthening of the external position while at the same time pursuing comprehensive structural reforms that are aimed at

sustaining high-quality economic growth in the context of domestic and external financial stability. The main objectives of the three-year program are to sustain economic growth at 6½ percent a year, reduce the annual rate of inflation to 5 percent by the end of the period, strengthen gross official international reserves, and reduce the ratios of domestic and external debt to GDP. This would be accompanied by additional improvements in the structural aspects of the economy to strengthen its supply responsiveness, reduce its vulnerability to adverse external shocks, and improve social indicators.

Within this medium-term framework, the economic program for 1993/94 is designed to bring about a recovery in economic growth, reduce the rate of inflation, lower the external current account deficit, strengthen international reserves, and contain domestic and external debt. Significant and sustained efforts to strengthen the structure of the budget and to reduce the budget deficit lie at the heart of Pakistan's adjustment and reform efforts. With this in mind, the budget deficit is being reduced through a combination of revenue and expenditure measures that also address long-standing structural weaknesses in the fiscal area. Accordingly, the revenue measures seek to broaden the revenue base (including extending the tax net to the agriculture sector), improve the elasticity of the tax system, reduce antiproduction and antiexport biases, and enhance equity aspects. At the same time, the Government has formulated a core investment program to protect priority development projects, improve the overall efficiency of the public investment program, and emphasize basic social services.

Credit and monetary policies are designed to increase the effectiveness of mobilizing and allocating loanable funds and strengthening the integrity of the financial system. The programmed decline in bank borrowing for budgetary support will help contain domestic liquidity expansion, while at the same time providing sufficient credit to the private sector for productive purposes. To enhance the conduct and effectiveness of monetary policy, steps have been taken to increase the autonomy of the State Bank of Pakistan.

The Government's structural policies are also designed to achieve further progress in the liberalization of economic activity in order to enhance the supply responsiveness of the economy, generate sustainable employment growth, and improve the country's social indicators. The privatization program will be expanded, with proceeds used to meet the cost of privatization (including worker retraining), retire public debt, and finance the Social Action Program (SAP) (see below). The other main aspect of the deregulation program is to enlarge private sector participation in utilities, insurance, investment and commercial banking, roads, railways, ports, and airline operations. As regards the external sector, a significant reduction in tariff rates and a simplification of the tariff system are being accompanied by the removal of quantitative restrictions and further liberalization of the exchange and payments system.

Emphasizing its commitment to address the shortfalls in basic social services, the Government has developed the Social Action Program, which focuses on four main areas: primary education; primary health care; population control; and rural water supply and sanitation. The SAP provides an important "umbrella" approach to enhancing social services, in that it also allows for more effective coordination of existing targeted programs to protect the most vulnerable segments of the population in the adjustment and reform process. At the same time, efforts are under way to improve the unemployment, pension, and health benefit systems.

The framework for Pakistan's environment protection program is being provided by the National Conservation Strategy, which was formulated with the assistance of Pakistan's main donors. Ongoing programs include projects to address salinity, waterlogging, and reforestation. In addition to strengthening the institutional capacity and supporting legislation and public awareness programs, further progress is to be made in improving regulations and standards governing air, water, and waste contamination.

Pakistan joined the IMF on July 11, 1950, and its quota is SDR 758.2 million (about US$1.053 billion). Its outstanding financial obligations to the IMF currently total SDR 798.7 million, (about US$ 1.109 billion).

Press Release No. 94/7, February 22

Senegal: Stand-by Arrangement. The IMF approved a credit for Senegal in an amount equivalent to SDR 47.56 million (about US$66.70 million) to support the Government's economic policies over the next 12 months. The money is being made available under a one-year stand-by arrangement, which is a way of providing IMF financial help to a member country while it takes steps to overcome balance of payments difficulties.

The background to Senegal's request for the IMF loan lies in a serious worsening of its financial situation in 1992 and the first half of 1993, when its external current account deficit widened and the Government ran up arrears on both its foreign and domestic debts. There was, at the same time, an increase in the Government's budget deficit, a flight of capital from the country, and a sharp fall in the money supply. Although the Government has succeeded in narrowing the budget deficit with a package of measures, announced in August 1993, to increase revenue and contain expenditure, there has been little improvement in Senegal's external position.

In addition, Senegal experienced weak economic growth and a loss of international competitiveness since the mid-1980s. The decline in competitiveness stemmed partly from the strengthening of the CFA franc against both the U.S. dollar and the currencies of other developing countries, and wage levels that became relatively higher in Senegal than those of similar developing countries.

The package of measures adopted in 1993 was not enough to restore sustained growth and external financial viability. Thus, after consulting other members of the CFA franc zone, the Government decided to broaden and strengthen its strategy of economic adjustment by devaluing the CFA franc against the French franc on January 12, 1994.

The Government's strategy over the next three years aims at stimulating economic growth, returning to low inflation by 1996, and cutting the current account deficit of the balance of payments after a temporary increase in 1994. The Government hopes to achieve these goals through the devaluation, together with the pursuit of tight fiscal and monetary policies, and faster structural reform of the economy. Within this medium-

term strategy, the 1994 program supported by the stand-by credit sets out to achieve real economic growth of 2.7 percent in 1994, to be followed by 5 percent from 1995; limit inflation to 39 percent in 1994, returning it to 8 percent in 1995, and to pre-devaluation levels in 1996; and hold the external current account deficit to less than 11 percent of GDP.

The actions taken in January 1994—including increases in administered prices, reduction of customs duties, and pursuit of a moderate wage policy—constitute a major first step. To achieve the 1994 economic objectives, the program envisages a tightening of the Government's budgetary position. The latter will benefit from the measures adopted last August and will be further strengthened in 1994 as a result of higher revenues that will come largely from increases in customs receipts. On the spending side, the Government plans to cut the amount it allocates to salaries and to strictly control non essential outlays. The program also calls for eliminating external payments arrears and repaying about two thirds of the Government's domestic arrears.

Senegal: Selected Economic Indicators

	1992	1993	1994[1]	1995[2]	1996[2]
Real economic growth (percent change)	2.9	-0.8	2.7	5.0	5.5
Consumer price index (percent change)	—	-0.7	39.1	7.8	2.5
External current account deficit (excluding transfers; percent of GDP)	-9.3	-9.7	-10.7	-8.3	-7.4
Overall balance of payments deficit (millions of SDRs)	-58.9	-156.0	-96.5	-37.1	2.1
Budget deficit (commitment basis; excluding grants; percent of GDP)	-3.7	-3.8	-3.6	-2.1	-1.2

[1]program
[2]projected

Data: Senegal authorities and IMF staff estimates

Consolidation of the fiscal position will have to be accompanied by a prudent credit policy, geared toward achieving the balance of payments objective, as well as a flexible interest rate policy that allows for efficient allocation of scarce financial resources. To facilitate this, member countries of the Central Bank of West African States (BCEAO) will need to coordinate closely their monetary and other economic and financial policies.

Structural reforms will concentrate on promoting private sector growth and export competitiveness. The Government will continue to promote price liberalization so that the prices of most items will be determined by market forces, although it will limit temporarily price rises of essential foods. In the trade area, the Government signed on January 10, 1994 a treaty on economic integration among countries of the West African Monetary Union to promote trade within the region.

Senegal has taken steps to limit the impact of the devaluation on the poor by controlling price increases of staples, while improving basic social services. In addition to government safety net measures, a program targeting the poorest social groups will be put in place.

If the objectives of the Government's program are to be met, the policies and measures it calls for need to be carried out effectively and adapted swiftly to changes in circumstances. At the same time, the success of the program will depend on timely foreign assistance, including debt relief, and the support of all sectors of the population.

Senegal joined the IMF on August 31, 1962. Its quota is SDR 118.9 million (about US$166.8 million), and its outstanding financial obligations to the IMF total the equivalent of SDR 177.9 million (about US$249.4 million).

Press Release No. 94/9, March 3

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Evolution of International Capital Markets Has Implications for Developing Countries

In the following article, based on a presentation to the Management Association of Pakistan, Mohamed A. El-Erian of the IMF's Middle Eastern Department discusses key aspects of developing countries' relations with international capital markets.

In recent years there has been a pronounced trend toward the internationalization and integration of capital markets, accompanied by greater institutionalization of financial savings and a broader and increasingly complex range of financial instruments.

This trend has not been limited to industrial countries. Developing countries have also been involved in this trend, as is evident in the surge in developing country international placement of bonds and equities; large private capital flows from industrial to developing countries; and increased institutional linkages—including mergers and strategic alliances—between firms in industrial and developing countries.

There are three key aspects to this trend:

- the main factors affecting increased developing country integration;
- the associated benefits and costs; and
- the policy implications.

These issues are relevant not only to several East Asian and Latin American countries, which already have substantial links with international capital markets, but also to countries at earlier stages in the process that have embarked on comprehensive macroeconomic adjustment and structural reform programs. Indeed, most developing countries confront a basic policy question: how to benefit from the process of increased capital market integration while limiting the associated risks—that is, how to improve the risk-return equation.

Causes of Increased Integration

After nearly a decade of limited flows, developing countries mobilized some $32 billion through international syndicated loans, bonds, and equities in 1990; for the first 11 months of 1993, flows are estimated at more than $75 billion. Bond and equity financing—negligible in the 1980s—amounted to $8 billion in 1990 and $60 billion in the first 11 months of 1993.

The list of recipient countries has also grown. It now includes, in addition to the traditional large Latin American and East Asian borrowers, such countries as Guatemala and the Philippines. (Coverage of some regions—notably sub-Saharan Africa—remains extremely limited.) The investor base has expanded to cover institutional investors and, through an increasing number of international mutual funds, small investors.

Four elements have played a particularly important role in this process: (1) the evolution of investors' perceptions of developing country risk; (2) structural and regulatory changes in the international investment process; (3) tailoring of financial instruments by developing countries; and (4) developments in industrial country markets.

Changing risk perceptions. In recent years, a number of developing countries have implemented comprehensive macroeconomic adjustment and structural reform policies, in many cases supported by the IMF arrangements. These policies, which have been critical in attracting and sustaining international capital inflows, have in some cases also been accompanied by a re-profiling of external liabilities.

Several countries have experienced improved prospects for investment and sustained economic growth. Private sector concerns regarding transfer risk have also been alleviated, as the reform of the exchange and external payments regimes provided greater assurances on the availability and pricing of foreign exchange. In some heavily indebted countries, this has been reinforced by reduced debt overhangs following comprehensive debt restructuring.

Structural and regulatory changes. Structural and regulatory changes that facilitate international investor response have accompanied the improved developing country "fundamentals." Technological progress—particularly in information flows and payments and settlement systems—has reduced transaction costs. In addition, several developing countries have opened their capital markets to foreign investors as part of a broader program of economic and financial liberalization. At the same time, changes in industrial country market regulations have lowered the regulatory costs that developing country financial instruments face. These changes include a rationalization of procedures governing registration, disclosure, and minimum credit rating standards; the relaxation of restrictions on investment abroad by institutional investors; and the emergence of a broader range of vehicles (such as mutual funds) for these investments.

Instruments tailored for developing countries. Developing countries have increasingly been able to tailor their financial instruments, particularly in the initial stages of market entry. Key aspects of this include placing an appro-

priate "benchmark" instrument on the basis of which subsequent issues may be priced off; targeting specific markets or investor segments; and incorporating features to address particular credit risk concerns, combined with judicious use of derivatives.

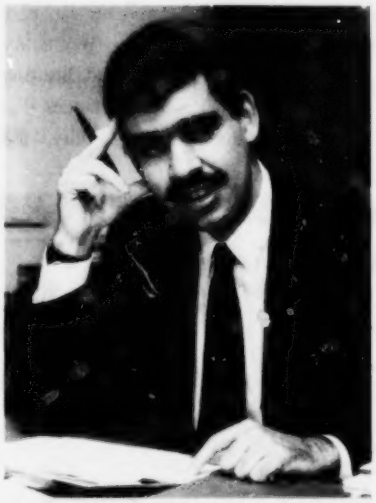
Developments in industrial countries. These first sets of "pull" factors have enhanced the absolute profitability of investing in developing countries. "Push factors" have also operated. Thus, the response of investors has also been affected by the expected returns on alternative investments. Given expectations of relatively stable bilateral exchange rates, reduced nominal yields in industrial country markets (especially in the United States) are believed to have induced investors to seek opportunities in developing countries.

Benefits and Costs of Integration

The most obvious benefit of integration is a larger pool of available capital from which to finance productive investments—which is particularly important, given increased pressures on industrial country aid budgets. Greater integration also facilitates the operation of price signals in lieu of what has proved to be more disruptive market clearing through quantity rationing.

Another benefit—specific to equity financing—is that the "servicing" of this flow (through profit transfers and dividend payments) is linked directly to the performance of the underlying investment. Unlike bonds and loans, there is a correspondence in equity financing between the capacity to meet the payments and the contractual obligations. The attractiveness of foreign direct and portfolio investment increases in the context of a relatively high stock of debt.

Greater integration also enhances the ability to use market-based risk management to reduce the cost of unfavorable terms of trade. This is particularly



El-Erian: Most developing countries confront a basic issue: how to benefit from integration and limit the risks.

important for countries with limited trade diversification. The reduction in risk perceptions has provided several developing countries with access to cost-effective hedging tools that limit the impact of unanticipated adverse developments in commodity prices, as well as international interest rates.

Finally, as investors become increasingly familiar with investment opportunities, positive "externalities" can ensue, including greater foreign direct investment and expanded export markets. Other potential spillover effects include improved financial intermediation resulting from the increased liquidity and efficiency of developing country financial markets, and a transfer of expertise and technology. By increasing the immediate costs of policy slippages and therefore providing for a more effective disciplinary instrument on policy makers, greater integration can also enhance policy credibility.

At the same time, greater integration entails important challenges for policymakers. As noted, with a more open capital account, an economy becomes more vulnerable to shifts in investor sentiment. Policy slippages translate more quickly into capital outflows and currency substitution. Moreover, developing countries' capital markets may become more sensitive to price instability in industrial country markets.

Surges in capital inflows may also induce inflationary pressures and appreciation in the real effective exchange rate, with pot lly adverse effects on internati petitiveness. The related e more pronounced whe duced flows—and associat fects in financial mark tant and where privat capital primarily in short-term financial instruments. (In equity or long-term debt instruments, outflows can be partly offset by the decline in the face value of the instruments.)

Policy Implications

The main public policy question posed by greater integration is how to improve the risk-return equation. Three poli y steps are vital.

- Most critical is the pursuit of prudent economic and financial policies to strengthen supply responsiveness, reduce inflationary pressures, and maintain an adequate international reserve cushion. This, along with appropriate debt management policies, allows for a sustained improvement in country-risk variables and provides the best environment for productive investments.
- Appropriate monitoring of the scale and composition of capital flows is also essential. This provides timely and comprehensive information needed to assess macroeconomic implications and design appropriate policy responses. It is particularly important to monitor the country's external liabilities to avoid excessive indebtedness.
- Also important is further progress in banking and payment system reform, including a strengthening of prudential regulation and supervision of the financial sector, and improved account-

ing and disclosure requirements. Regulatory and supervisory strengthening is important to reduce operational risks, such as those associated with maturity and currency mismatching.

Finally, industrial countries can play a role in further harmonizing regulatory and supervisory regimes, and limiting macroeconomic policy imbalances that contribute to asset price instability. ■

Stand-By, EFF, SAF, and ESAF Arrangements As of January 31, 1994

(million SDRs)

Member	Date of Arrangement	Expiration Date	Amount Approved	Undrawn Balance
Stand-by arrangements			**1,926.33**	**1,520.44**
Costa Rica	April 19, 1993	February 18, 1994	21.04	21.04
Czech Republic	March 17, 1993	March 16, 1994	177.00	107.00
Dominican Republic	July 9, 1993	March 28, 1994	31.80	15.00
El Salvador	May 10, 1993	March 9, 1994	34.55	34.55
Estonia	October 27, 1993	March 26, 1995	11.63	9.30
Guatemala	December 18, 1992	March 17, 1994	54.00	54.00
Hungary	September 15, 1993	December 14, 1994	340.00	283.30
Jordan	February 26,1992	February 25, 1994	44.40	11.10
Kazakhstan	January 26, 1994	January 25, 1995	123.75	111.38
Kyrgyz Republic	May 12, 1993	April 11, 1994	27.09	15.48
Latvia	December 15, 1993	March 14, 1995	22.88	22.88
Lithuania	October 22, 1993	March 21, 1995	25.88	20.70
Moldova	December 17, 1993	March 16, 1995	51.75	47.25
Pakistan	September 16, 1993	September 15, 1994	265.40	177.40
Panama	February 24, 1992	September 23, 1994	74.17	29.47
Poland	March 8, 1993	March 7, 1994	476.00	476.00
Viet Nam	October 6, 1993	October 5, 1994	145.00	84.60
EFF arrangements			**4,124.98**	**1,795.06**
Argentina	March 31, 1992	March 30, 1995	2,483.15	890.00
Egypt	September 20, 1993	September 19, 1996	400.00	400.00
Jamaica	December 11, 1992	December 10, 1995	109.13	63.75
Peru	March 18, 1993	March 17, 1996	1,018.10	375.41
Zimbabwe	September 11, 1992	September 10, 1995	114.60	65.90
SAF arrangements			**83.23**	**38.27**
Comoros	June 21, 1991	June 20, 1994	3.15	2.25
Ethiopia	October 28, 1992	October 27, 1995	49.42	14.12
Rwanda	April 24, 1991	April 23, 1994	30.66	21.90
ESAF arrangements			**1,727.71**	**707.96**
Albania	July 14, 1993	July 13, 1996	42.36	33.89
Benin	January 25, 1993	January 24, 1996	46.95	31.30
Bolivia	July 27, 1988	March 31, 1994	163.26	13.61
Burkina Faso	March 31, 1993	March 30, 1996	48.62	39.78
Burundi	November 13, 1991	November 12, 1994	42.70	23.49
Equatorial Guinea	February 3, 1993	February 2, 1996	12.88	10.12
Guinea	November 6, 1991	November 5, 1994	57.90	40.53
Honduras	July 24, 1992	July 23, 1995	40.68	27.12
Kenya	December 22, 1993	December 12, 1994	45.23	22.62
Lao P.D.R.	June 4, 1993	June 3, 1996	35.19	29.33
Lesotho	May 22, 1991	August 1, 1994	18.12	3.78
Malawi	July 15, 1988	March 31, 1994	66.96	5.58
Mali	August 28, 1992	August 27, 1995	60.96	40.64
Mauritania	December 9, 1992	December 8, 1994	33.90	8.48
Mongolia	June 25, 1993	June 24, 1996	40.81	31.54
Nepal	October 5, 1992	October 4, 1995	33.57	22.38
Sri Lanka	September 13, 1991	September 12, 1994	336.00	112.00
Tanzania	July 29, 1991	July 28, 1994	181.90	96.30
Uganda	April 17, 1989	June 30, 1994	219.12	--
Zimbabwe	September 11, 1992	September 10, 1995	200.60	115.50
TOTAL			**7,862.25**	**4,061.73**

Note: EFF = extended Fund facility.
SAF = structural adjustment facility.
ESAF = enhanced structural adjustment facility.
Figures may not add to totals because of rounding.

Data: IMF Treasurer's Department

Pakistan's Adjustment

(continued from front page) on the path to high sustained growth, financial stability, and improved social sector performance, Pakistan embarked on a program of macroeconomic and structural reform. In the first phase of this adjustment and reform effort, which began in 1988, Pakistan made significant gains in structural reforms, but was unable to achieve sufficient fiscal adjustment. The vulnerability of the country's economy was exposed by a series of adverse exogenous developments in 1992/93 (July–June fiscal year).

Pakistan intensified its medium-term adjustment and reform program in 1993/94 in response to a weakening of its external financial position and inflationary pressures. To support this program, the IMF's Executive Board recently approved the ESAF and EFF arrangements. Implementation to date has succeeded in, among other things, reducing domestic imbalances and strengthening Pakistan's balance of payments, as well as drawing a favorable response from foreign direct and portfolio investors.

First Phase of Adjustment and Reform: 1988/89–1991/92

Pakistan initiated a comprehensive program of macroeconomic adjustment and structural reforms in 1988/89. Its objective was to restore external viability, while maintaining satisfactory growth in the context of declining inflation.

Under the program, Pakistan recorded significant progress in its structural reform efforts. This progress was reflected in measures to liberalize the external trade and payments system, decontrol domestic activity, reform the financial sector, and initiate wide-

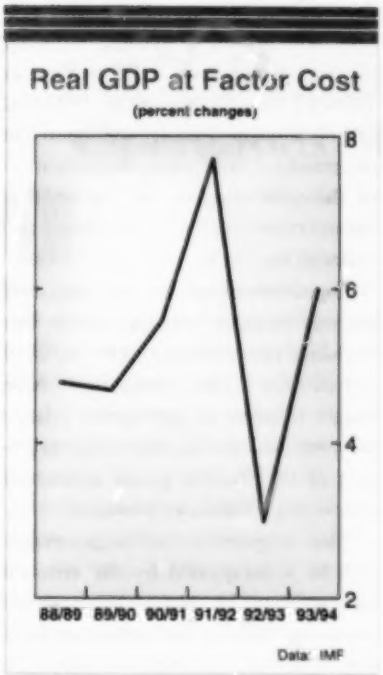
ranging privatization. The structural reforms contributed to strong GDP and export growth, higher domestic and foreign investment, and greater dynamism in the private sector.

These achievements, however, were not complemented by macroeconomic adjustment policies, which were implemented on neither a full nor a sustained basis. During 1988/89–1989/90, the fiscal deficit narrowed, and liquidity growth was restrained. The fiscal deficit widened in the following two years, however, and domestic liquidity expanded—contributing to double-digit inflation. Macroeconomic conditions were complicated by unfavorable movements in export prices and the 1990–91 Middle East crisis, which brought about higher oil import prices and disruptions in both export markets and inflows of worker remittances. The associated deterioration in its external current account position prompted a further increase in its foreign liabilities—including short-term obligations.

Economic Setbacks in 1992/93

Pakistan's domestic and external imbalances were aggravated in 1992/93. Widespread flooding in September 1992 and unfavorable external terms of trade compounded problems arising from insufficient fiscal adjustment. In the second half of the fiscal year, the economic situation was also affected by a high degree of political uncertainty.

Extensive flood-related damage to the cotton crop, and its consequent impact on manufacturing activities, contributed to a sharp reduction in the GDP growth rate (see chart above). Associated revenue losses and rehabilitation and reconstruction expenditures widened the country's fiscal deficit. With exports reduced and imports expanded by flood-related outlays, Pakistan's current account deficit worsened and its external reserve position deteriorated (See chart on page 65).



Following the provision of emergency food, shelter, and medicine after the flood, the authorities implemented a set of corrective macroeconomic measures in mid–1992/93, supported by emergency financial assistance from the IMF. The corrective policies attempted to adjust prices, intensify revenue collection, and contain budgetary expenditures. On the monetary front, the authorities increased the discount rate and the liquid asset ratio. Pakistan imposed a temporary import surcharge, while exchange rate policy continued to aim at maintaining the competitiveness of the tradables sector and containing inflation.

These measures reduced the fiscal deficit and produced a sharp deceleration in domestic credit in the second half of 1992/93. Their favorable impact was more than offset, however, by the adverse impact of domestic political uncertainties. Thus, official foreign exchange reserves came under pressure, declining to 2.3 weeks of imports by the end of June 1993.

Second Phase of Reform: 1993/94–1996/97

In response to continuing domestic and external imbalances, Pakistan intensified its medium-term adjustment and structural reforms in 1993/94. Its efforts aimed to strengthen the country's external position, develop the supply side of its economy, reduce vulnerability to external shocks, and improve its social indicators. This effort was initially supported by a stand-by arrangement from the IMF (approved on September 16, 1993), which was subsequently replaced by the ESAF and EFF arrangements.

Medium-term framework. Pakistan's adjustment efforts are aimed at achieving certain key macroeconomic objectives over the medium term:

- sustaining annual economic growth at about 6.5 percent;
- reducing inflation from 9.5 percent currently to 5 percent by the end of the program period;
- raising gross official reserves to about three months of imports; and
- reducing the burden of domestic and external debt.

Underlying these objectives are medium-term targets for intermediate macroeconomic variables, including a large reduction in the budget deficit. This reduction is predicated on a strengthened budget structure achieved through a more efficient taxation system, reduced public outlays for low priority projects, and enhanced productivity of government spending—including greater emphasis on basic social services.

Improved budgetary operations are to be accompanied by better mobilization and allocation of loanable funds; further liberalization of the exchange, trade, and payments systems; and further deregulation and privatization of domestic economic activities.

Fiscal Policy. In the key area of fiscal policy, the strategy includes an exten-

sion of direct taxes to the agricultural sector, coupled with a reform of the general sales tax into a modern broadly based value-added tax. These improvements will increase the growth rate of domestic tax revenues and provide the foundation for a shift away from distortionary international trade taxation. These measures are to be accompanied by sustained efforts to contain expenditures, with particular emphasis on reducing nonproductive outlays.

Monetary policy. The monetary policy component of Pakistan's adjustment plan targets a tightening of credit and monetary conditions, improving the process of mobilizing and allocating loanable funds, and strengthening the central bank and domestic financial institutions. A major feature is the phasing out of direct central bank control over the credit operations of the commercial banks in the context of greater central bank reliance on indirect methods of monetary control, such as open market operations. The program also envisages reducing concessional and government-directed credit schemes, enhancing competition in the banking sector, and strengthening prudential regulation and supervision.

External Sector Policy. The trade policy component of Pakistan's adjustment program emphasizes the removal of nontariff barriers in the course of a thorough revamping of the tariff system. This strategy envisages reducing maximum tariff rates to 35 percent in 1996/97 from 92 percent in 1993/94. Other features include reductions in intermediate tariff rates, simplification of the tariff structure, and a simultaneous reduction in exemptions and concessions.

Improvement in the domestic and external financial balances requires that exchange rates continue to be managed responsively. The authorities have sought to strike an appropriate balance between maintaining the competitiveness of the tradable goods sector and containing inflationary pressures.

The responsive exchange policy will be accompanied by the removal of restrictions on current international payments. Indeed, the authorities have indicated their intention to accept the obligations under Article VIII of the IMF's Articles of Agreement by the end of June 1994—thereby committing themselves to avoiding restrictions on payments and transfers for current international transactions. Such a step would provide domestic and foreign investors with a strong signal of the Government's commitment to maintain a sound and prudent policy stance.

Supply-Side Policies. The privatization program and additional steps to liberalize domestic economic activity are key elements in the authorities' strategy to enhance the supply side of the economy. Expanded privatization will be accompanied by the opening up of new activities (such as utilities and insurance) to the private sector, further simplification of the investment regime, and the removal of remaining price distortions.

Social Safety Net. The Government has emphasized its commitment to address serious shortfalls in Pakistan's basic social services. Its Social Action Program provides a framework for this commitment and represents a broadly based effort to improve the country's social services. The Government is also trying to improve the country's unemployment, pension, and health benefits systems. These initiatives are expected to reinforce the favorable effect of sustained employment growth on Pakistan's social indicators.

Program Goals and Implementation in 1993/94

Within its medium-term framework, Pakistan's program for 1993/94 includes the following macroeconomic objectives:

- a sharp rebound in economic growth;
- a reduction in inflation; and
- a lowering of the external current account deficit concurrent with a significant strengthening of gross official reserves.

To this end, the financial program for 1993/94 seeks a reduction in the budget deficit (excluding grants) to 5.4 percent from 7.9 percent in 1992/93, and a containment of domestic liquidity growth to 14.5 percent. These objectives are designed to anchor the projected price performance.

Pakistan's authorities have been pursuing their 1993/94 objectives in a determined and comprehensive manner. Pakistan has adopted several important fiscal measures, including the extension of a direct tax net to agriculture, an increase in the rate and coverage of the sales tax, and a rationalization of trade taxes (by lowering the maximum tariff rate and reducing exemptions). Petroleum and utility prices have been adjusted substantially in conjunction with the introduction of a mechanism to make domestic petroleum prices more responsive to changes in international prices. In addition, the authorities' fiscal program for 1993/94 envisages a reduction in

SDR Rates

Week Beginning	Interest and Charges (percent)
Feb. 28	4.03
March 7	4.12

The rate of SDR interest and charges is calculated weekly, by reference to a combined market interest rate, which is the weighted average of interest rates on specified short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket (U.S. dollar, deutsche mark, Japanese yen, French franc, and pound sterling). The interest rates used are those that prevail each Friday. For the latest weekly rates call (202) 623-7171.

Data: IMF Treasurer's Department

military spending by about 1 percent of GDP, along with a containment of nonessential expenditures.

The authorities have tightened monetary policy through upward adjustments in the rates of return and reductions in the scope of concessional and mandatory credit schemes. The framework for conducting effective monetary policy has been strengthened through the provision of increased autonomy to the central bank.

Finally, the Pakistan rupee was devalued by 10 percent at the outset of the fiscal year. This has been followed by a series of small exchange rate adjustments implying a total devaluation of 12 percent vis-à-vis the U.S. dollar and a real effective depreciation.

The Pakistan economy has responded well to the implementation of the adjustment policy package. The budget deficit for the first six months of 1993/94 has been broadly in line with the targets and is significantly lower than the deficit for the corresponding period in 1992/93. The expansion in the net domestic assets of the banking system has been well within the target, reflecting moderation in bank financing of the budget and restrained private sector credit.

These elements have contributed to slower growth in overall domestic liquidity than targeted by the program. The reduction in domestic financial imbalances has contributed to a strengthening of the balance of payments—as reflected in a substantial recovery in gross reserves to some $1.2 billion by the end of January 1994—assisted by a favorable response on the part of foreign direct and portfolio investors.

In sum, the design of the medium-term adjustment and reform program, and its implementation to date, have placed Pakistan in a favorable position to exploit its considerable economic potential. ■

Government Finance Statistics Yearbook. . .

IMF Documents Government Operations of 114 Countries

The effect of central government operations on the economies of industrial countries, as measured by their overall deficits or surpluses as percentages of GDP, was more uniform in 1991 than in 1990, according to the IMF's recently released *Government Finance Statistics Yearbook*. Of the 15 industrial countries for which 1991 data are published, 12 had deficits and 3 had surpluses, with the corresponding ratios to their GDPs ranging from a deficit equivalent to almost 12 percent for Luxembourg to a surplus of almost 2 percent for New Zealand. Paralleling these results, compared with the previous year, 6 countries had increases in their deficit/GDP ratios, 3 had decreases in their surplus/GDP ratios, 3 went from a surplus to a deficit, and 3 had decreases in their deficit/GDP ratios.

When comparing the size of central government operations to the level of economic activity, it should be remembered that countries differ in their governmental structures and therefore in the responsibilities that different levels of government exercise. In a federal system in which there is a strong secondary level of government, the central government's share of economic activity is usually smaller than in a highly centralized system, where the central government collects most taxes and provides most government services. This situation is evident when total central government revenue as a percent of GDP is compared for industrial countries. In 1991, only 3 reporting countries had such percentages below 30 percent, 2 of which were the federal countries of Australia and the United States (which had the only percentage under 20 percent). The highest share, almost 50 percent, was recorded by the Netherlands, while 3 other countries were in the 40–49 percent, and 7 were in the 30–39 percent, range.

A similar pattern was evident for outlays (total expenditure and lending *minus* repayments) as a percent of GDP, with the only 2 observations below 30 percent recorded for Australia and the United States. Five countries were in the 30–39 percent, and 5 were in 40–49 percent, range, while 2 countries—Belgium and the Netherlands—had outlays of over 50 percent.

In developing countries, the central governments of 30 of the 39 countries for which 1991 data are available had overall deficits, 8 had surpluses, and 1 had a balance of zero. Twenty-three of the 39 reporting countries reported either smaller deficits or larger surpluses in relation to GDP, compared with the previous year. The largest ratio of deficit to GDP, just over 15 percent, was reported by Zaïre, while Singapore recorded the biggest surplus, over 9 percent. Among developing countries, 10 of 11 in Africa, 8 of 10 in Asia, 2 of 3 in Europe, 4 of 5 in the Middle East, and 6 of 10 in the Western Hemisphere had deficits.

The central government's revenue as a percent of GDP was usually much smaller in developing than in industrial countries. Of the developing countries for which 1991 data are available, only 2 of 11 in Africa, 6 of 10 in Asia, 1 of 3 in Europe, 1 of 5 in the Middle East, and 3 of 10 in the Western Hemisphere had ratios above 30 percent, while 17 developing countries globally

had ratios below 20 percent.

With regard to outlays, most developing countries also had percentages below 30 percent of GDP, with only the developing countries in Europe and the Middle East having, on average, a different result. All 3 European, 3 of 5 Middle Eastern, 5 of 11 African, 2 of 10 Asian, and no developing countries in the Western Hemisphere had shares over 30 percent.

Industrial Countries

Revenues. Taxes on income and profits, together with social security contributions, provide the bulk of the revenue base of most central governments of industrial countries. In 1991, only 4 Nordic countries—Denmark, Finland, Iceland, and Sweden—reported that these sources produced less than half their total revenues. Reliance on these taxes continued to be greatest for the United States, where, unlike most other industrial countries, there is no national sales tax; in the United States, they accounted for 86 percent of total revenues, with Belgium next at 70 percent. In 6 European countries, social security contributions produced more revenue than did taxes on income and profits, with Germany continuing to record the largest share of such contributions, at almost 51 percent of total revenue. In contrast, no separate social security contributions were reported by Australia or New Zealand.

Taxes on domestic goods and services—including value-added, sales, and excise taxes—were the other main source of revenue for the central governments of most industrial countries. In 1991, these taxes continued to produce over 40 percent of total revenue for Finland, Iceland, and Denmark, and accounted for at least 20 percent in all reporting European industrial countries, as well as Australia and New Zealand. The major exception was the United States, where these taxes continued to account for less than 4 percent of total central government revenue. (In the United States, these taxes are levied predominantly by state and local governments.) Italy, Germany, and New Zealand have increased their reliance on this revenue source over the last five years.

Taxes on international trade and transactions were relatively unimportant as a revenue source for most industrial countries, one exception being Iceland, where these taxes produced almost 10 percent of total revenue. Nontax revenue was more significant than international taxes for all industrial countries in 1991, ranging from 3 percent in Italy to almost 14 percent for Denmark, with 3 other countries—New Zealand, Iceland, and Finland—each recording at least 10 percent.

Outlays. Data for 1991 on the expenditures of central governments by economic type show that subsidies and other current transfers accounted for 50 percent or more of the outlays of all but 2 industrial countries reporting. Two countries, Sweden and the Netherlands, had proportions over 70 percent, while 4 others were above 60 percent. Expenditures on goods and services ranged from 14 percent to 48 percent of total outlays, with only 3

1993 *GFS Yearbook* Also Features State and Local Data

The 1993 edition of the *Government Finance Statistics (GFS) Yearbook* provides detailed financial information on the government operations of 114 countries. Data are presented by country on consolidated central government revenue, grants, expenditure, lending, financing, and debt; for some countries, separate details are provided on budgetary and extrabudgetary accounts of central government and social security funds. The *Yearbook* also provides similar, though less detailed, data for the state and local governments of many countries. No changes in the presentation of data have been made from the 1992 edition. To make the *GFS Yearbook* as accurate and current as possible, preliminary, provisional, and projected data are included wherever possible.

To facilitate international comparisons of central government operations, the *Yearbook* provides country data on selected topics grouped by region rather than by country. These tables show, both as a percent of GDP and by major category, total central government revenue, total expenditure, and total expenditure and lending *minus* repayments, as well as data on financing and overall deficit/surplus. As in previous editions, expenditure data on a functional basis include those on defense.

The 1993 *Government Finance Statistics Yearbook*, prepared by the Government Finance Division of the IMF's Statistics Department, may be purchased for $54.00. Computer tape subscriptions, which provide both more current data and data for earlier years, are also available. Please write to Publication Services, Box XS400, International Monetary Fund, Washington, D.C. 20431, U.S.A. (Telephone: (202) 623-7430; fax: (202) 623-7201.)

countries being above 30 percent. In contrast, the share of interest payments varied enormously across countries, ranging from 3 percent in Finland to 20 percent in Italy and Belgium. In only 1 country, Iceland, was the share of capital expenditure above 10 percent of total outlays. In 1991, the impact of privatization programs was again evident in the data for lending *minus* repayments. Four countries reported a net inflow in this category, with New Zealand's being particularly large.

Data on expenditure by function are not as frequently reported as other types of information in the IMF's government finance statistics system. For those industrial countries for which such information was available for 1991, the expenditure category that received the biggest share of government funds in all but one country was social security and welfare, with shares ranging from 20 percent in Iceland to 52 percent in Sweden. Health expenditures received the second largest share in most countries, followed by education, and economic affairs and services. Reflecting differing institutional arrangements, there were wide differences between countries in the relative importance of certain types of central government expenditure. This was particularly noticeable for education, which in 1991 received under 2 percent of total expenditures in the United States, compared with almost 14 percent in Finland. There was also a large variation in the relative importance of defense expenditures, which accounted for almost 21 percent of expenditure for the United States, compared with just over 2 percent for Austria.

Developing Countries

Revenues. In contrast to industrial countries, where taxes on income and social security contributions provided the bulk of central government revenue, the most important revenue sources for the central governments of many developing countries were taxes on domestic and international goods and services. Of the 59 developing countries for which 1991 (1992 for Belarus and Bulgaria) data were available, 36 reported that at least 40 percent of their total revenue came from these taxes. Reliance on this revenue source continued to be highest in Africa, the Western Hemisphere, and Asia, where 73 percent of 44 reporting countries were in the over-40 percent category, and lowest in the Middle East and Europe, where only 4 of 16 reporting countries—Belarus, Estonia, Jordan, and Lithuania—were in this category.

Taxes on income and profits, together with social security contributions, accounted for at least 40 percent of total central government revenue in only 12 developing countries. Half of these countries were in Europe, reflecting, for 5 of them, the legacy of

Strengthening National Accounting in Russia

As Russia's transition to a market-oriented economy unfolds, national accounts concepts and reporting mechanisms associated with a centrally planned economy become increasingly inadequate. As a result, the margin of error associated with basic price and quantity estimates widens substantially. A new IMF working paper by Vincent Koen discusses the problems in correctly estimating conventional national accounts indicators.

In the last few years, Koen explains, the Russian State Statistical Committee (Goskomstat) has undertaken considerable work, with the technical assistance of several multilateral institutions including the IMF, to bring Russian macroeconomic statistics in line with international norms. The project is long term in nature, with progress to date genuine but slow. Consequently, the uncertainty surrounding macroeconomic estimates and projections is likely to have worsened recently, according to Koen. Official data on rates of change in real GDP—current changes in output as compared with those in the late 1980s—may be misleading as such data were substantially overstated in the old regime; indeed, Koen states, incentives under central planning were geared toward overreporting, whereas such incentives have now been clearly reversed.

Over time, the quality of information collected and the methods for processing it are expected to improve, as will the precision of the national accounts. The sooner financial stabilization is achieved, the sooner this improvement will materialize.

Of equal or greater importance to correct estimation of conventional national accounts is the need for more comprehensive measures of economic welfare, the author concludes. These measures would include the gains associated with the end of shortages and queues, which are hard to quantify, and the welfare gains resulting from an end to overproduction of a number of items and a wasteful use of inputs.

Copies of "A User's View on National Accounts in Russia," by Vincent Koen, IMF Working Paper 94/6, cost $7.00 each. They may be ordered from Publication Services, Box XS400, International Monetary Fund, Washington, D.C. 20431, U.S.A. (Telephone: (202) 623-7430; fax: (202) 623-7201.)

the former centrally planned system, which mandated high social security contributions. The majority of countries in Africa and Asia, as well as half the Middle Eastern countries, reported no social security contributions.

Nontax revenue was a significant source of income for many developing countries, accounting for at least 15 percent of total revenue for 29 of them, including all 6 reporting countries in the Middle East and 10 of 17 in Asia. Entrepreneurial and property income was the major element of nontax revenue for 24 of these countries.

The importance of grants as a source of receipts varied substantially among developing countries, with 9 countries reporting grants equivalent to at least 20 percent of total nongrant revenues, while the comparable ratios for 3 countries—Chad, Bhutan, and Tonga—were 100 percent or more.

Outlays. The pattern of expenditure by economic type shows marked differences between developing and industrial countries. In 1991, the central governments of 37 of 49 developing countries for which such data are available reported that at least 20 percent of total outlays was spent on wages and salaries, while among industrial countries, only 1 country—Iceland—had a percentage above 20 percent, and 5 of 13 reporting countries had percentages below 10 percent.

Subsidies and other current transfer payments, which accounted for at least 50 percent of the outlays of all but 2 industrial countries, were not as significant for developing countries, with this level of expenditure being reported by only 8 countries, which included the former centrally planned countries of Bulgaria, Czechoslovakia, Estonia, Lithuania, and Romania, as well as Brazil, Chile, and Uruguay. Expenditures in this category of under 10 percent of total outlays were reported by 16 developing countries.

For interest payments, however, the situation was more comparable between developing and industrial countries, with only 6 of the former—Kenya, India, Pakistan, the Philippines, Brazil, and Peru—recording interest expenditures of 20 percent or more of total outlays.

Central government capital expenditure was much more important in developing than in industrial countries. Of 58 reporting developing countries, all but 4 recorded capital expenditure of at least 10 percent of total outlays, compared with 1 of 14 reporting industrial countries.

When expenditures are examined on a functional basis, industrial and developing countries again display dissimilar patterns. While social security and welfare was a major focus of expenditure for industrial countries in 1991, only 14 developing countries reported spending 15 percent or more of their total expenditure on such activities, with European countries accounting for 6 of these. A major area of expenditure for developing countries—particularly in Africa, Asia, and Europe—was economic affairs and services, for which 32 of 48 reporting countries indicated an expenditure share of at least 15 percent. Other activities that tended to absorb a significant share of expenditures in developing countries were general public services and public order, and education. Defense was also a priority for developing countries in the Middle East and Asia, with all 6 reporting countries in the Middle East and 5 of 13 reporting countries in Asia having defense expenditures amounting to at least 15 percent of total expenditures. Not unexpectedly, the highest relative level of defense expenditures—68 percent of total outlays—was reported by Kuwait, owing to high costs incurred during the Middle East crisis of 1990-91. ■

Donald Keith McAlister,
IMF, Statistics Department

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